

Service Date: May 5, 1987

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Montana Power)	
Company's Motion for a Declaratory)	
Rule that Sale/Leaseback Arrange-)	DECLARATORY RULING
ments Do Not Constitute Security,)	
or in the Alternative, an Applica-)	DOCKET NO. 86.4.12
tion for Approval of a Lease)	
Between the Montana Power Company)	
and Beneficial Finance Corporation.)	

Background

1. On or about April 2, 1986, the Montana Power Company (MPC) filed a Motion for a Declaratory Ruling that Sale/Leaseback Arrangements Do Not Constitute Security, or in the Alternative, an Application for Approval of a Lease Between the Montana Power Company and Beneficial Finance Corporation (Beneficial).

2. MPC was contemplating a leveraged lease of a new computer center building. MPC paid for the construction of the building and was considering a sale and leaseback of it. The lease with Beneficial was to be a net lease, with an initial term of 20 years. The purchase of the new building would be accomplished through debt and equity investments, with notes issued as debt secured by the building itself and/or the lease payments. For the amount of \$1.00 (one dollar) per year, MPC would lease all land and property rights upon which the building was located to Beneficial, for a period of twenty (20) years. MPC would have an option to purchase the building for fair market value at the end of the initial term, or to renew the lease for

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various additional terms at prevailing fair market rental value. MPC was required to represent that the useful life of the building would be at least twenty-five (25) years, with a residual value at the end of the initial term of at least 20 percent of total building cost. The proceeds of the sale to Beneficial would be used by MPC to pay down short-term debt incurred for construction of the building. The lease payments would be approximately \$250,000 per year. However, the lease contemplated the possibility of adjustments to this amount, in order to preserve Beneficial's "After-tax Economic Return, After-tax Cash Flow and Ratio of After-tax Cash to Initial Investment," collectively described as "Net Return."

3. On April 21, 1986, at a regularly scheduled meeting, the Montana Public Service Commission (PSC) voted to approve the lease as a security, in the event that it was later determined to require such action. The question raised for purposes of a declaratory ruling, that is, whether or not such a lease constitutes security which must receive PSC approval under §69-3-501, MCA, was not resolved.

4. On October 7, 1986, the PSC voted to inform interested parties of the pending Motion for Declaratory Ruling, and to allow said parties an opportunity to comment on the issues raised therein. Notice was sent to the following: Montana Power Company (MPC); Montana-Dakota Utilities Co.; Pacific Power & Light Co. (PP&L); Great Falls Gas Co.; and the Montana Consumer Counsel. Comments were received from MPC and PP&L.

Discussion, Analysis and Findings

5. Section 69-3-501, MCA, provides as follows:

Regulation of issuance of securities and creation of liens by utilities. (1) Whenever a public utility furnishing electric or gas service in the state has revenue derived from sources in Montana which exceeds \$5 million or 5% of its gross revenue, the utility's right to issue, assume, or guarantee securities and to create liens on its property in the state is subject to the regulation and supervision of the commission, as set forth in this part.

(2) The public utility, when authorized by order of the commission and not otherwise, may issue stocks and stock certificates and may issue, assume, or guarantee other securities payable at periods of more than 12 months thereafter for the following purposes:

- (a) the acquisition of property;
- (b) the construction, completion, extension, or improvement of its facilities;
- (c) the improvement or maintenance of its service;
- (d) the discharge or lawful refunding of its obligations;
- (e) the reimbursement of money actually expended for said purposes from income or from other money; or
- (f) any other purpose approved by the commission.

6. The comments filed by both MPC and PP&L contend, for various reasons, that the type of transaction at issue in this proceeding does not constitute a security or a security issuance, assumption or guarantee, as found in §69-3-501, MCA. Both parties rely on technical application and construction of the language found in the statute.

7. In addition, both parties point out that this type of transaction is a frequent occurrence. In this regard, if the PSC finds that these transactions are subject to regulation and review under §69-3-501, MCA, then both parties argue that the PSC should adopt some type of exemption for "immaterial" transactions falling within this category.

8. In general terms, there are two different types of lease transactions. The first is described as an ordinary or operating lease. The second is usually referred to as a capital (or financing) lease. In certain important respects, the two are quite the same: for specific periodic payments, the lessor acquires the right, for a specified duration, to take possession of and to put to its own use certain property whose legal title remains with the lessee.

9. However, a capital lease is typically for the entire useful life of the property (or a substantial portion of it), and the total lease payments equal the lessor's cost, usually with a suitable return on investment. Finally, a capital lease is usually a net lease, wherein the lessee (not lessor) is responsible for such matters as maintenance, insurance, taxes, and other traditional "incidents of ownership." See Re Green Mountain Power Corporation, 76 PUR 4th 270 (Vt. PSC, 1986).

10. Generally, the lease agreement between MPC and Beneficial shares these features. The initial term of the lease is for 20 years. The lease may be renewed for up to five years. MPC is required to represent that the building will have a use-

ful life of at least twenty-five (25) years. In addition, the annual lease payments, and thus, total lease payments, are adjustable to insure a particular "net return" to Beneficial from the transaction. Further, the lease is a "net lease," with MPC assuming responsibility for the majority of the "incidents of ownership." Finally, at the end of the initial term, MPC would have the option to purchase the building, apparently at a price not lower than 20 percent of the total cost.

11. The question, then, is whether or not this type of transaction is covered by the requirements of §69-3-501, MCA. That is, whether or not the legislature intended the PSC to have jurisdiction over this sort of transaction. The answer to this question necessarily involves a review of the language found in §69-3-501, MCA, in light of the broad purposes for its enactment.

12. The broad purposes behind legislation such as §69-3-501, MCA, are twofold. First, the regulation of securities in this manner helps to protect investors from overcapitalization. Second, and in addition, proper securities regulation also protects the interests of ratepayers in assuring continued service without interruption from utilities and in receiving that service at reasonable rates.

13. It is in this light that the phrase "...issue, assume, or guarantee other securities..." must be examined. With the broad, underlying purposes of §69-3-501, MCA, in mind, it is reasonable to conclude that this language encompasses not only stan-

dard debt investments, but also nontraditional forms of debt-type financing. A capital lease serves the same basic purpose as debt, and is essentially a form of financing. R.E. Brealey & S. Myers, *Principles of Corporate Finance*, 541-42 (1984); J. Mao, *Corporate Financial Decisions*, 465-66 (1976); VanHorne, *Financial Management and Policy*, 478 (6th ed.).¹

14. Accordingly, the Commission believes that capital leases, such as the one in this proceeding, are covered by §69-3-501, MCA. However, the Commission also recognizes that §69-3-501, MCA, was intended to require regulation of financing transactions which have a significant impact upon the utility. The traditional forms of such financing transactions do not usually occur in insignificant amounts. The capital lease at issue in this proceeding involves assets of substantial value, but such leases are often used to finance relatively small "acquisitions." Individual proceedings to review such matters would be an inappropriate use of resources, and possibly contrary to the intent underlying §§69-3-501 et seq., MCA. To this end, the Commission believes that some type of "blanket approval" for these smaller transactions would be appropriate. It would appear that every year, and for each utility subject to §69-3-501, MCA, the Commission could issue an order "approving

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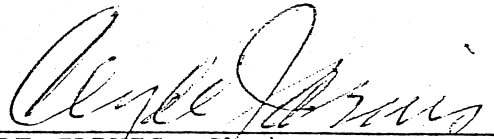
Even the MPC Board of Directors referred to the subject lease as a "financing" transaction. See Application, Exhibit B, Resolution of the Board of Directors Approving the Transaction.

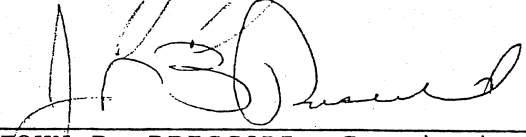
in advance" sale/lease transactions under a certain amount (to a cumulative total). The utilities subject to §69-3-501, MCA, are encouraged to work with the Commission staff to develop such guidelines.

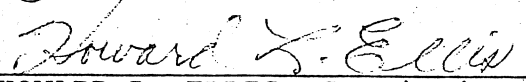
15. The Commission finds and declares by law that capital leases, such as the one at issue in this proceeding, fall within the reach of §69-3-501, MCA. Consistent with this funding, Commission approval of such a transaction is required. The declaratory ruling requested by Montana Power in its Petition is Denied.

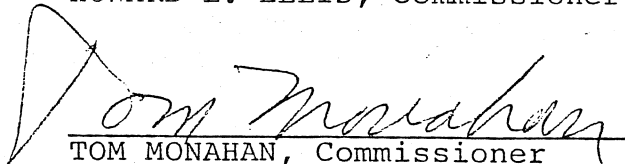
APPROVED BY THE COMMISSION May 5, 1987, by a vote of
5 - 0.

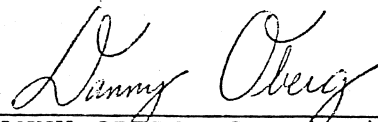
BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION


CLYDE JARVIS, Chairman



JOHN B. DRISCOLL, Commissioner


HOWARD L. ELLIS, Commissioner


TOM MONAHAN, Commissioner


DANNY OBERG, Commissioner

ATTEST:


Ann Purcell
Acting Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.